United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

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76-6025

To be argued by
J. CHRISTOPHER JENSEN

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket No. 76-6025

MODULAR TECHNICS CORPORATION,
Plaintiff-Appellant,

—*against*—

UNITED STATES DEPARTMENT OF HOUSING and URBAN DEVELOPMENT and FEDERAL HOUSING ADMINISTRATION,
Defendants-Appellees,

SOUTH HAVEN HOUSES HOUSING DEVELOPMENT FUND COMPANY, INC. and CHEMICAL BANK,
Defendants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NEW YORK

BRIEF FOR THE APPELLEES

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Preliminary Statement

This is an appeal from a final judgment of the United States District Court for the Eastern District of New York (Platt, *J.*) in favor of the United States Department of Housing and Urban Development (HUD) and Federal Housing Administration (FHA) dismissing appellant's complaint as to these federal appellees on the ground that the doctrine of sovereign immunity bars the asserted claims. By order dated January 22, 1976, the district judge determined that there was no just reason to delay entry of judgment in favor of the federal appellees pursuant to Rule 54(b). Accordingly,

judgment was entered by the clerk on January 22, 1976, in accordance with the opinion and order of the district judge dated November 18, 1975 (decision reported *sub nom Modular Technics Corp.* v. *South Haven Houses Housing Development Fund Company, Inc.*, at 403 F. Supp. 204) dismissing the complaint against the appellees pursuant to Rule 12(b) of the Federal Rules of Civil Procedure.

Appellant brought this action in the Supreme Court for the State of New York, Nassau County, to recover contract and tort damages against the South Haven Houses Housing Development Fund Company, Inc., (South Haven) Chemical Bank and appellees, HUD and FHA. A summons and complaint were served upon the Area Counsel for the New York Area Office of HUD on September 18, 1974. On October 3, 1974, appellees removed the case to the United States District Court for the Eastern District of New York.

Upon the appellees' motion to dismiss the complaint, the district court found that the various causes of action asserted in the complaint against appellees, whether sounding in tort or contract, were not encompassed either by the statutory waiver of the sovereign immunity of the Secretary of HUD, 12 U.S.C. § 1702, or the waiver of the United States' immunity from tort liability under the Federal Tort Claims Act, 28 U.S.C. §§ 1346(b), 2679 and 2680(h).

Statement of the Case

Appellant is apparently a building contractor who entered into a contract with South Haven for the construction of certain residential buildings in Bronx, New

York.[1] (Complaint, ¶ 6, 5a; Exhibit A annexed to complaint, 22a-35a).[2] Defendant Chemical Bank allegedly loaned monies to South Haven to finance the construction of the buildings in question. (Complaint, ¶¶ 25-27, 9a), and this loan was apparently secured by a mortgage on the property under development, given by South Haven as mortgagor to Chemical Bank as mortgagee. (Construction Contract, Article 9D, 29a). The mortgage was insured by the Federal Housing Commissioner acting on behalf of FHA and HUD (*Id.*).

Appellant's complaint states eleven causes of action, sounding in tort or contract, against South Haven, Chemical Bank and the appellees. These causes of action appear to arise in part from an alleged breach of the construction contract by South Haven at a time when the construction of the buildings in question was 96% complete. (Complaint, ¶ 21, 9a). In addition, appellant states several claims for damage as the result of alleged misrepresentations by South Haven, Chemical Bank and the appellees.

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[1] The record in this case consists of appellant's complaint, an affidavit of an Assistant United States Attorney in support of appellees' motion to dismiss the complaint and an affidavit of appellant's counsel in opposition. Since the latter affidavits do not contain factual allegations as such, this statement of facts is derived exclusively from the allegations of appellants' complaint which the district court deemed to be true for purposes of the appellees' motion to dismiss the complaint. Now, appellant's counsel seeks to rehabilitate his complaint by making various factual allegations in his brief on appeal to this Court. These allegations are not found in the complaint and formed no part of the record before the district court.

[2] Numerals followed by lower case "a" refer to the Joint Appendix which reproduces in full the complaint, the Exhibit attached to the complaint, and the affidavits filed on the appellees' motion to dismiss the complaint.

As set forth in its prayer for relief, appellant seeks judgment against the appellees only on the second, third, fourth, ninth and tenth cause of action of the complaint (15a-16a).[3]

Insofar as it applies to the appellees, the second cause of action alleges that the appellant "performed work, labor and services and furnished materials at the special instance and request of [HUD and FHA] . . ." (6a). This work was alleged to have been undertaken to meet "municipality requirements" and "unforeseen and extraordinary sub-surface conditions" (*Id.*) Similarly, the third cause of action alleges that appellant, at the request of HUD and FHA, performed work and furnished materials "in the nature of rework to take care of damage due to vandalism." Although appellant does not allege the existence of any written agreement or contract between appellant and appellees to perform this work, both of these two causes of action are essentially contract claims in the nature of promissory estoppel. Neither of these two claims appear to relate appellant's construction contract with South Haven as such. Rather, they are claims for services and materials provided by appellant in addition to, and extraneous to, the general construction contract with South Haven which is appended to appellant's complaint (22a-35a).

The fourth, ninth and tenth causes of action seem to be tort claims for damage done to the appellant as

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[3] In the Brief of Appellant previously filed herein, the appellant seeks to add another cause of action against appellees by asserting that HUD and FHA are also liable to the appellant on the Eleventh Cause of Action in the complaint (Brief of Appellant at 3). Obviously, appellant cannot assert on appeal a new claim which was not included in its complaint in the district court. If appellant has discovered a new cause of action against HUD and FHA, its remedy is to file an appropriate civil action against these defendants on its new claim.

the result of alleged misrepresentation and breach of warranty by appellees.[4] Specifically, the fourth cause of action alleges that FHA "warranted" that the appellant would be able to perform "its agreements" in accordance with plans and specifications allegedly prepared by representatives of FHA. (7a). Appellant alleges further that these plans and specifications were inaccurate and as a result, the appellant was damaged by being required to expend a greater amount to perform on its agreements (*Id.*).

The ninth cause of action alleges that FHA falsely represented that appellant would be paid additional compensation for certain unspecified "extra work, services and materials." (12a-13a). (Presumably, this allegation refers to representations made by representatives or employees of FHA, since FHA itself cannot "represent" anything.) Appellees assume that this cause of action refers to compensation for work and materials that are in addition to, and extraneous to, those covered by the appellant's construction contract with South Haven. Paragraph 51 of the complaint also includes an additional allegation under the ninth cause of action that representatives or employees of HUD and FHA interfered with appellant's efforts to obtain compensation under its contract with South Haven.

The tenth, and last cause of action asserted against appellees also alleges that FHA made certain "misrepresentations." In this instance, the misrepresentation was

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[4] For reasons unknown to the appellees, the fourth and tenth causes of action each refer only to FHA, while the ninth cause of action refers to both FHA and HUD. Since 1965, the FHA has not existed as a separate legal entity, Pub. L. 89-174 § 9(c) (September 9, 1965). The distinction between the two, for purposes of this lawsuit, is meaningless since neither FHA or HUD is a suable entity. *Blackmar* v. *Guerre*, 342 U.S. 512, 515 (1939).

in the form of an omission to state certain material facts "of which plaintiff had no knowledge" concerning the "extent and degree of theft and vandalism" in the area of the building under construction. (14a). Appellant alleges that, as a result of this intentional omission by FHA, appellant incurred the uncompensated expense of providing safeguards against theft and vandalism. Finally, appellant alleges under the tenth cause of action that the FHA has damaged appellant by refusing to permit occupancy of the building which appellant states is the only safeguard against theft and vandalism.

In the *ad damnum* clause, the appellant's complaint demands judgment against appellees for what seems to be liquidated contract damages on the second and third cause of action in the amount of $239,332.37 and $224,-720.00, respectively. Appellant also demands judgment against appellees on the tenth cause of action for apparent tort damages in the sum of $5,000,000.00 and, in the alternative, demands judgment against appellees on the ninth cause of action for the sum of $6,153,369.00. Although this latter amount appears to be a liquidated sum, it is unclear what the sum represents and it is also unclear why judgment for this sum is demanded only as an alternative to judgment against appellees on the ninth cause of action in the amount of $5,000,000.00.

ARGUMENT

POINT I

The claims asserted in appellant's complaint against HUD and FHA are barred by sovereign immunity.

The appellants have presented this Court with two different lawsuits. The first consists of the various claims submitted to the district court in appellant's allegations in its complaint. The second, and completely novel, lawsuit is the one the appellant has presented to this Court in its brief on appeal.

The new claims asserted in the Brief of Appellant were obviously not considered by the district court and formed no basis of its decision dismissing appellant's complaint as to the appellees herein on the grounds that each and every cause of action asserted in the complaint is barred by the appellees' sovereign immunity from suit. Thus, the appellees respectfully suggest that this Court's appellate review must, of necessity, be limited to the allegations of the complaint which form the entire material record on this appeal.

A. The Tort Claims

The appellant asserts five causes of action against the appellees in its complaint. Three of these causes of action are for misrepresentation, interference with contract rights and breach of warranty.[5] Specifically it is alleged that the appellees, in some unspecified fashion,

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[5] The fourth, ninth and tenth cause of action in the complaint (7a, 12a-14a).

knowingly made false representations to the appellant concerning its ability to perform on its construction contract with South Haven. As a result, appellants allege that they incurred additional expense in completing their contract.

The district court regarded these three claims as "speaking in tort, not in contract" (37a), although the court did not analyze the distinction in much detail because of its view that both "contract" and "tort" claims would be precluded by the appellees' sovereign immunity.

Appellees believe it is important to note at the outset however, that the appellant is confusing the terms "warranty" and "misrepresentation" with respect to the underlying factual allegations in the complaint. There is a significant historical distinction between the contract claim for breach of warranty and the tort claim of deceit although both are occasionally referred to under the general rubric of "misrepresentation". *See, Prosser, The Law of Torts*, § 105, at 685-687 (4th ed. 1971); *Harper and James, The Law of Torts*, §§ 7.1-7.2, at 527-532.

Historically, deceit was closely allied to what we now understand to be a breach of warranty, in that it was used as a remedy for misrepresentations or false warranties on a contract for services or the sale of goods, *Prosser, supra*, at 685. The leading case at English common law establishing the modern action of deceit is *Pasley* v. *Freeman*, 3 Term. Rep. 51, 100 Eng. Rep. 450 (1789) which held that an action for deceit would lie where the plaintiff had no direct dealings with the defendant but had been induced by defendant's misrepresentation to deal with another person. Later the distinction between the actions was sharpened and the action for breach of warranty came to be viewed as an action in assumpsit on a direct contract between the

parties. *Prosser*, *supra* at 685. This is in contradistinction to an action for deceit where the basis of the action is not a direct contractual relationship between the parties, but rather is predicated upon the right of the plaintiff to formulate his business judgments without being misled by others. *Harper* and *James*, *supra*, at 527.

As the district court implicitly found below, it is clear that the allegations set forth in the fourth, ninth and tenth cause of action in the appellant's complaint make out a claim for the tort of deceit rather than for breach of warranty on a contract, since it is not alleged that there ever was any contract between the appellant and appellees with respect to additional costs incurred from unanticipated subsurface conditions, municipality requirements or theft and vandalism.

The basic remedy against the federal government for the torts of its employees committed within the scope of their employment is the Federal Tort Claims Act (hereinafter Tort Claims Act), 28 U.S.C. § 1346(b), which is both jurisdictional and a waiver of the sovereign immunity of the United States. *Rayonier, Inc.* v. *United States*, 352 U.S. 315, 319 (1957); 1 *Jayson, Personal Injury, Handling Federal Tort Claims*, § 3 (1974).[6]

However, certain specific exceptions to this waiver of immunity are set forth in 28 U.S.C. § 2680 which provides in pertinent part:

> The provisions of this chapter and Section 1346(b) of this title shall not apply to—
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> * * * * *

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[6] Appellant could not utilize this remedy in any event because of its failure to comply with the absolute jurisdictional prerequisite of filing an administrative claim. 28 U.S.C. § 2675.

> (h) Any claim arising out of assault, battery, false imprisonment, false arrest, malicious prosecution, abuse of process, libel, slander, *misrepresentation, deceit or interference with contract rights* . . . (Emphasis added)

It is well established that this exception to the statutory waiver of sovereign immunity absolutely precludes suit for torts involving misrepresentation, deceit, or interference with contract rights. *United States* v. *Neustadt*, 366 U.S. 696, 701-703 (1961); *Jones* v. *United States*, 201 F.2d 563 (2d Cir. 1953); *Edelman* v. *Federal Housing Administration*, 382 F.2d 594 (1967); *Thompson* v. *United States*, 408 F.2d 1075 (8th Cir. 1969).

There is a statutory waiver of immunity for the Secretary of HUD which allows her to "sue or be sued", 12 U.S.C. § 1702,[7] but it is not applicable to tort claims as a result of 28 U.S.C. § 2679 which makes the Tort Claims Act exclusive. *Edelman* v. *Federal Housing Administration*, *supra*, 382 F.2d at 596. This latter section provides:

> The authority of any federal agency to sue and be sued in its own name shall not be construed to authorize suits against such federal agency on claims which are cognizable under Section 1346(b) of this title, and the remedies provided by this title in such cases shall be exclusive.

This Court has already held in *Edelman*, *supra*, that § 2679(a) absolutely precludes any action against the Commissioner of FHA under 12 U.S.C. § 1702 for deceit or misrepresentation by officials of FHA. *See also Freeling* v. *F.D.I.C.*, 221 F. Supp. 955 (W.D. Okla. 1962),

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[7] See discussion of 12 U.S.C. § 1702, *infra* at pp. 14-20.

aff'd, 326 F.2d 971, (10th Cir. 1963); *United States* v. *Gregory Park, Section II, Inc.* 373 F. Supp. 317 (D.N.J. 1974). The only change now, of course, is that 12 U.S.C. § 1702 refers to the Secretary of HUD rather than to the Commissioner of FHA, because of the reorganization of HUD previously adverted to at n.4, *supra*.

In fact, this Court went further and held in *Edelman* that any claim for an implied contract for "fair consideration" arising from the alleged representations of FHA officials would also be barred because such a "contract" claim would still be, in substance, a claim for fraud and misrepresentation. 382 F.2d at 597. In this case, any claim for an "implied contract" because of statements allegedly made by HUD or FHA officials would also be barred by sovereign immunity as being, in substance, a claim for misrepresentation or deceit within the meaning of 28 U.S.C. § 2680(h).

In *United States* v. *Neustadt*, *supra*, the Supreme Court specifically considered a claim against FHA for misrepresentation or deceit by a mortgagor on an FHA insured mortgage. In circumstances very similar to the instant complaint, single-family home purchasers on a FHA insured mortgage claimed that they were induced to buy a defective house because of reliance upon a misleading FHA inspection and appraisal of the property.

Plaintiffs in *Neustadt* recovered a judgment in the district court for FHA's "negligence" in carrying out the inspection and appraisal, but this judgment was reversed by the Supreme Court on the grounds that the action, in essence, was for misrepresentation and deceit by FHA officials and, as such, was barred by sovereign immunity because of the exceptions to the Federal Tort Claims Act in 28 U.S.C. § 2680(h). The Supreme Court carefully examined the substance of the plaintiffs' claims

and concluded that the action was for the tort of misrepresentation rather than for a breach of a "specific duty" as had been found by the circuit court in affirming the judgment.

The Supreme Court reviewed the mortgage insurance provisions of the National Housing Act and found no "specific duty" was owed to the plaintiffs because FHA in inspecting and appraising a property was intended to act exclusively to protect itself as the potential insurer of the mortgage and that any benefit to the plaintiffs was purely incidental.

In crucial language for purposes of the instant appeal, the Court stated that the legislative history revealed that:

> . . . it was repeatedly emphasized that the primary and predominant objective of the appraisal system was the "protection of the Government and its insurance funds"; that the mortgage insurance program was not designed to insure anything other than the repayment of loans made by lender-mortgagees; and that "there is no legal relationship between FHA and the individual mortgagor." Never once was it even intimated that, by an FHA appraisal, the Government would, in any sense, represent or guarantee to the purchaser that he was receiving a certain value for his money.
>
> Nor is there any indication that Congress intended, by its 1954 addition of § 226, to modify the legislation's fundamental design from a system of mortgage repayment insurance to one of guaranty or warranty to the purchaser of the value received.

Neustadt, supra, 366 U.S. at 709. Of course, the appellant, as contractor with the FHA insured mortgagor

is one giant step further removed from being able to claim any breach of a contractual or "specific duty" relationship with FHA in carrying out its function as the insurer of the building mortgage. Appellant's fourth, ninth and tenth causes of action, like those asserted in *Neustadt*, are not contractual, but are fundamentally for torts specifically exempted from the waiver of immunity in the Tort Claims Act, 28 U.S.C. § 2680(h).

Thus, the district court was clearly correct in concluding that these tort claims could not be asserted against the federal government under the Tort Claims Act. Although not specifically discussed by the district court, it is equally true that these tort claims may not have been asserted against the Secretary of HUD under the "sue and be sued" provision of 12 U.S.C. § 1702 because of the exclusivity of the Tort Claims Act in this instance, 28 U.S.C. § 2679(a); *Edelman, supra.*

B. Contract Claims

The second and third causes of action alleged in appellant's complaint are claims that appellant performed certain labor and furnished materials at the specific instance and request of HUD and FHA without receiving compensation. In its brief to this Court, the appellant has sought to characterize all of its claims against appellees as contract or quasi-contract claims. Although the district court basically viewed the other four causes of action as tort claims, as appellees have argued above, the court found it unnecessary to decide that question because of its conclusion that sovereign immunity existed with respect to the activities alleged in the complaint even if viewed as giving rise to contract claims against appellees.

The district court began its analysis with the axiom that the United States as sovereign may not be sued without its consent, *United States* v. *Sherwood*, 312 U.S. 584 (1941). *Soriano* v. *United States*, 352 U.S. 270 (1957), *Honda* v. *Clark*, 386 U.S. 484, 501 (1967); *United States* v. *Testan*, —U.S.—, 96 S. Ct. 948 (1976), and that government agencies and government officials acting within the scope of their official duties are also clothed with sovereign immunity unless there has been a specific Congressional waiver of such immunity. *Keifer & Keifer* v. *Reconstruction Finance Corp.*, 306 U.S. 381 (1939). *Blackmar* v. *Guerre*, *supra*, 342 U.S. 512; *Malone* v. *Bowdoin*, 369 U.S. 643 (1962) and *Dugan* v. *Rank*, 372 U.S. 609 (1963).

In the instant case, the only conceivable statutory waiver of sovereign immunity that might be applicable to appellants "contract" claim is 12 U.S.C. § 1702 which provides in part,

> The Secretary shall, in carrying out the provisions of this subchapter and subchapters II, III, V, VI, VII, VIII, X, IX-A, and IX-B, of this chapter, be authorized in his official capacity, to sue or be sued in any court of competent jurisdiction, State or Federal.

The scope of this statutory waiver has been defined by the Supreme Court in *Federal Housing Administration, Region No. 4* v. *Burr*, 309 U.S. 242 (1940) in which the Court held that FHA was subject to garnishment under § 1702 for the debts of its employees. The Court stated that this waiver of governmental immunity was to be liberally construed unless it be "clearly shown that certain types of suits are not consistent with the statutory or constitutional scheme." 309 U.S. at 245. Since the

Supreme Court found that one of the subchapters covered by the § 1702 waiver specifically authorized the FHA administrator to appoint employees and to fix their compensation, the Court concluded that an FHA employee himself would be able to sue for his wages under § 1702 and that this was indistinguishable from allowing the employee's creditors to garnish those same wages, 309 U.S. at 249.

The district court in the instant case applied this analysis to appellant's "contract" claims and concluded that there was "no part of the relevant subchapters of Title 12" which authorized such a contract and, therefore, the § 1702 waiver was inapplicable (49a).

The overall purpose of the ten subchapters of the National Housing Act referred to in § 1702 is "to promote the construction and purchase of residential housing by creating an extensive system of insuring home mortgages." *City of Sacramento* v. *Secretary of Housing and Urban Development*, 363 F. Supp. 736, 738 (E.D. Calif. 1972). Although this purpose could perhaps have been implemented directly by authorizing the government itself to build this housing. Congress also wanted to stimulate the economy by arranging for this construction to be financed and done by the private sector. The Supreme Court has described this Congressional purpose as follows:

> The plain objective of the Housing Act was to stimulate the building trades and to increase employment. In order to induce banks and other lending institutions to get the program under way, Congress promised that the United States would make good up to 20% on the losses they might incur on such loans. As between the government and the lending institution, it was clearly intended that the United States should bear the losses resulting from defaults.

> But beyond this, we may not go. . .
>
> * * * * *
>
> The purpose of Title I was not the strengthening of the general credit of property owners, but the stimulation of the building trades by affording assurances to lending institutions to induce them to make loans for property improvements.

United States v. *Emory*, 314 U.S. 423, 430, 433 (1941) (footnotes omitted).

Each of the ten subchapters covered by the § 1702 waiver of immunity is intended to promote this basic scheme. Eight subchapters authorize the Secretary of HUD to insure mortgages for various types of housing and other developments.[8] Another subchapter establishes government corporations to purchase and sell federally insured mortgages on the secondary market, subchapter III, 12 U.S.C. § 1716 *et seq.* The final subchapter contains various miscellaneous administrative provisions, subchapter V, 12 U.S.C. § 1731 *et seq.*

The program of mortgage insurance involved in this action arises under subchapter II and specifically under § 236 of the National Housing Act, 12 U.S.C. § 1715z-1. Section 236(j) 12 U.S.C. § 1715z-1(j), provides:

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[8] Subchapter I, 12 U.S.C. § 1702 et seq. (insurance for housing renovation loans); subchapter II, 12 U.S.C. § 1707 et seq. (basic mortgage insurance for private residential dwellings). Subchapter VI, 12 U.S.C. § 1736 et seq. (mortgage insurance for veterans); subchapter VII, 12 U.S.C. § 1747 (mortgage insurance for rental housing for moderate income families); subchapter VIII, 12 U.S.C. § 1748 (armed forces housing mortgage insurance); subchapter X, 12 U.S.C. § 1750 (national defense housing insurance); subchapter IX-A, 12 U.S.C. § 1749aa (mortgage insurance for development of new communities); and subchapter IX-B, 12 U.S.C. § 1749aaa (mortgage insurance for medical facilities).

> (1) The Secretary is authorized, upon application by the mortgagee, to insure a mortgage (including advances on such mortgage during construction) which meets the requirement of this subsection. Commitments for the insurance of such mortgages may be issued by the Secretary prior to the date of their execution or disbursement thereon, upon such terms and conditions as he may prescribe.

In brief, the Secretary may obligate himself, *upon application of a mortgagee*, to insure the mortgage on prescribed terms and conditions.

This obligation is expressed by a mortgage insurance commitment to the mortgagee that is a binding contract between FHA and the mortgagee presenting the application, 24 C.F.R. § 200.147. The mortgage does not actually become insured, however, until endorsement by the Commissioner of FHA upon the mortgage note. This endorsement constitutes the actual "contract of insurance" with the mortgagee and incorporates the "terms, conditions and provisions" of the National Housing Act and the regulations promulgated thereunder. 24 C.F.R. § 207.25(d), (e).

In addition to this insurance contract, of course, there is normally a building loan agreement between the mortgagee (Chemical Bank) and the mortgagor (South Haven). There is also the construction contract between South Haven and the appellant that is appended to appellant's complaint (22a-35a).

The insured mortgage is the security for a building loan agreement that typically provides for periodic loan advances to the mortgagor equal to the value of labor and material acceptably furnished with respect to the

building under construction. The mortgagor, in turn, has an obligation under its agreement with the appellant to make periodic payments on the construction contract for work completed.

There is absolutely no authority for the Secretary of HUD under any of the relevant statutes and regulations to contract, either expressly or by implication, for the construction, repair or maintenance of a residential building. The appellant does not, and cannot, cite a single statute or regulation to that effect.

The only thing argued by the appellant is that the "government controls the financial arrangement and takes responsibility for the execution of the project." (Appellant's Brief at 8). In support of this contention, the appellant cites the fact that the building loan agreement and construction contract are government prepared forms and that installments under either agreement must be approved by HUD (*Id.*).

Appellant overlooks the obvious and sole purpose of the HUD activities to protect HUD from insuring a loan that is inadequately collateralized. The Courts have repeatedly recognized that the various provisions of the FHA mortgage insurance programs, and by implication the agreements implementing these provisions, are exclusively for the protection of the Government. *United States* v. *Neustadt, supra; United States* v. *Emory, supra; Davis* v. *Romney*, 490 F.2d 1360, 1372 (3d Cir. 1974); *United States* v. *Longo*, 464 F.2d 913, 916 (8th Cir. 1972); *United States* v. *Chester Heights Associates*, 406 F. Supp. 600 (D.S.C. 1976); *United States* v. *Gregory Park Section II, Inc., supra*, 373 F. Supp. 317; *Trans-Bay Engineers & Builders, Inc.* v. *Lynn*, 396 F. Supp. 265 (D.D.C. 1975); *United States* v. *Lawrence Towers, Inc.*, 236 F.

Supp. 208 (E.D.N.Y. 1964).[9] Thus, even though it can be said that HUD's supervisory interest in the project under construction is an authorized activity related to carrying out the FHA mortgage insurance program, that interest is not synonymous with authority, express or implied, to contract directly with the construction company.

Appellees submit that the district court was absolutely correct when it held, in effect, that even if the allegations that HUD implicitly contracted with the appellant are deemed to be true, these "actions of the federal government's representatives cannot be deemed actions carrying out the provisions of the relevant subchapters." (40a).

This view is consistent with the few cases in which the issue of authorized activity under 12 U.S.C. § 1702 has been discussed. *City of Sacramento* v. *Secretary of HUD, supra; Akin Mobile Homes* v. *Secretary of HUD*, 354 F. Supp. 1036, 1040 (S.C. Miss. 1972), *aff'd*, 475 F.2d 1261 (5th Cir. 1973). Both of these decisions involved actions against the Secretary which were found to be outside of the § 1702 waiver of immunity. In *City of Sacramento* the Court concluded that § 1702 was not consent to a suit for condemnation of property held by the

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[9] Appellant cites this Court's recent decision in *Caramico* v. *Secretary of HUD*, 509 F.2d 694 (2d Cir. 1974) for the proposition that insurance provisions of the National Housing Act were intended to benefit more than the insured mortgagees. This decision, in a wholly different context, held that tenants in buildings insured under the Act were "intended beneficiaries" of the Act because of the general Congressional goal of better housing. 509 F.2d at 700. However, the Court noted that the prime beneficiaries were the mortgagees and mortgagors. *Id.* at n. 13. Nothing in this decision can be construed as stating that HUD may be sued by a general contractor as an implied party to a construction contract.

Secretary, 363 F. Supp. at 738. In *Akin Mobile Homes* the Court held that an action by a company to enforce an alleged oral contract to lease mobile homes was not within the purview of the § 1702 waiver because it was not done by the Secretary of HUD under one of the subchapters referred to in § 1702, 354 F. Supp. at 1037.

C. The claims in appellant's brief

As noted above, the appellant has sought to introduce new factual allegations and new legal claims in its brief to this Court.[10] Since these matters were not raised or considered below, the appellant should be precluded from raising them now. The issue on appeal is whether there has been any waiver of sovereign immunity with respect to the causes of action alleged in the complaint. Should this Court determine that there has been a waiver, we respectfully suggest that the action be remanded to the district court for further proceedings to ascertain whether plaintiff has alleged claims upon which relief may be granted.

However, since the appellant has raised new contentions on appeal, we will briefly address them here. Appellant has seemingly abandoned any argument with respect to

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[10] One of these claims concerns the question of whether the appellant would have to bring his action in the Court of Claims under the Tucker Act, 28 U.S.C. § 1346(a)(2) since the amount in controversy exceeds $10,000 (Appellant's Brief, Point III). Since the Supreme Court has expressly held that the Tucker Act is merely jurisdictional and not a waiver of sovereign immunity, *United States* v. *Testan, supra,* 96 S. Ct. at 953-954, appellant's ability to sue in that forum would equally depend upon the waiver of immunity under 12 U.S.C. § 1702.

Because the decision below found no such waiver, appellees do not think it is necessary for this Court to reach the question of the $10,000 limitation under the Tucker Act.

its tort claims and urges only that it should be allowed to sue the Secretary of HUD under 12 U.S.C. § 1702 as "an implied party to the transaction between the plaintiff and the sponsor-mortgagor of the project." (Appellant's Brief at 4). There is some reference to this "implied" contract theory in the affidavit of appellant's counsel submitted in opposition to appellees' motion to dismiss the complaint (20a-21a), but there is no specific allegation to that effect in the complaint and appellant did not demand judgment against the appellees on the first cause of action which relates to the breach of its construction contract with South Haven. (4a-5a, 16a).

In addition, appellant now introduces claims of "unjust enrichment" "equitable lien," and "third-party beneficiary" against appellees predicated entirely on allegations of fact not contained in the complaint.[11]

In support of these new theories of recovery, the appellant cites a few decisions where construction contractors have been allowed to recover from the government on a building with an FHA insured mortgage. *F. W. Eversley & Co., Inc.* v. *The East New York Non-Profit HDFC, Inc., et al.*, Civil Action No. 75 Civ. 84 (S.D.N.Y. February 4, 1976); *B. B. Adams General Contractors, Inc.* v. *Department of Housing and Urban Development*, Civil Action No. 6186-E (N.D. Tex. May 18, 1973), *appeal dismissed*, 501 F.2d 176 (5th Cir. 1974); and *Travelers Indemnity Co.* v. *First National State Bank of New Jersey*, 328 F. Supp. 208 (D.N.J. 1971).

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[11] These allegations include for example, the allegations that the "sponsor-Mortgagor of the project are individual representatives of a community group, with no assets," (Appellant's Brief at 7); that the "government controls the financial arrangement and takes responsibility for the execution of the property," (Appellant's Brief at 8); that "the government is now in possession of any funds to which the plaintiff is entitled (because) . . . the mortgage was assigned," (Appellant's Brief at 12), etc.

The first thing to be noted about these decisions is that the problem of sovereign immunity was never specifically raised or considered by the courts, although the Fifth Circuit in rather strong dictum in the *B. B. Adams* case observed that the various jurisdictional arguments made by HUD "appear to be forceful and seem to have considerable case support," 501 F.2d at 178. The Fifth Circuit had to dismiss the appeal, however, because the order entered by the district court was not a final, appealable order.

The second thing to be said about these cases is that they represent a minority, and we believe erroneous, position on whether a contractor may sue the government on an FHA insured, mortgaged property. The correct view is set forth in *Housing Corporation of America* v. *United States*, 468 F.2d 922 (Ct. Cl. 1972); *United States* v. *Chester Heights Associates*, *supra*, 406 F. Supp 600; *Trans-Bay Engineers & Builders, Inc.* v. *Lynn*, *supra*, 396 F. Supp. 265.[12] These decisions quite clearly reject the "unjust enrichment," "equitable lien" and "third-party beneficiary" theories of recovery in cases that are factually identical to appellant's allegations in its brief.

In *Trans-Bay Engineers*, the district court assumed that the § 1702 waiver of immunity would be applicable, but did not dwell on this aspect because of its very strong

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[12] *See also* the many cases in which the Courts have found that there is no duty owed even to the mortgagors or tenants of an FHA-insured, mortgaged property, *e.g.*, *United States* v. *Neustadt*, *supra*, 366 U.S. 696, *United States* v. *Gregory Park Section II, Inc.*, *supra*, 373 F. Supp. 317; *Davis* v. *Romney*, 490 F. 2d 1360 (3d Cir. 1974). *Jackson* v. *Romney*, 355 F. Supp. 737 (D.D.C. 1974), *aff'd sub nom*, *Jackson* v. *Lynn*, 506 F.2d 233 (U.S. App. D.C. 1974); *United States* v. *Thompson*, 293 F. Supp. 1307 (E.D. Ark. 1967); *United States* v. *Lawrence Towers*, *supra*, 236 F. Supp. 208; *Cf. Caramico* v. *Secretary of HUD*, *supra*.

views that the plaintiff construction company did not, and could not, state any claim for relief against the Secretary of HUD. 306 F. Supp. at 268-272. The court in *Trans-Bay Engineers* found that even if the construction contractor is a third-party beneficiary under the building loan agreement, as appellant now argues (Appellant's Brief at 15-17), the contractor would be held to the terms of that building loan agreement, 356 F. Supp. at 270. Specifically, the court in *Trans-Bay* found that the contractor would be bound by a provision which allowed the mortgagee to stop making advances under the agreement whenever the borrower (*i.e.* South Haven) was in default under its note or mortgage (*Id.*).

In the instant case, the appellant actually alleges in his brief that there was a similar provision in the building loan agreement between Chemical Bank and South Haven (Appellant's Brief at 8) and that South Haven defaulted on its mortgage agreement with Chemical Bank resulting in an assignment of the mortgage to HUD under its insurance agreement with Chemical Bank. (Appellant's Brief at 4, 12). Thus, even if appellant were a third-party beneficiary under the building loan agreement, as it argues on this appeal, he would be precluded from any recovery. *Trans-Bay Engineers, supra; United States* v. *Chester Heights Associates, supra*, 406 F. Supp. at 606.

These courts distinguished *Travelers Indemnity Co., supra*, a decision relied upon by the appellant, in that "the *Travelers* court either did not consider or did not have before it the limitations in the building loan agreement which are present in the instant case." 396 F. Supp. at 270. The *Eversley* court implicitly recognizes the validity of the court's decision in *Trans-Bay Engineers* concerning the effect of a default upon the mortgagee's obligations

under the building loan agreement, but simply asserts "it is unreasonable to permit the government and banks to rely on such a defense." *Eversley, supra*, Slip Opinion at 10.

Appellant also contends for the first time that it has an equitable lien on unadvanced mortgage funds which it alleges are in the possession of the government as the result of an alleged assignment of the mortgage in this case. Although again, this was not in issue before the district court and cannot properly be considered on the present appeal, appellees believe it is important to note that the district court in *Trans-Bay Engineers* unequivocally rejected this theory of recovery against HUD, stating:

> Likewise, equitable lien principles cannot create vested rights in Trans-Bay which are contrary to express and implied contractual undertakings. It may be that Trans-Bay has completed its construction obligations down to the last nail in the building, that it is wholly without fault in the project's financial failure, and that it has relied exclusively upon the mortgage fund as a source of payment of the retention sum. It may also be, as in G. L. Wilson Bldg. Co. v. Leatherwood, 268 F. Supp. 609, 622 (D.C.N.C. 1967), that "[t]he United States at all times was fully acquainted with each step, however minute, that took place from the very inception of the dealings herein; down to and including the absolute completion of the project." Still, equity will not set aside legal obligations in order to provide relief for parties later disadvantaged nor will equity rewrite contracts to expand an insurer's liabilities or to restrict a promisee's risks and duties. (396 F. Supp. at 272).

Appellees submit that the *Eversley* decision is incorrect to the extent that it diverges from the analysis in *Trans-Bay Engineers.*

As for the argument of "unjust enrichment", appellees believe it should suffice to observe that when one of these large-scale residential projects goes into default, the government almost always sustains tremendous losses. The mortgagee gets paid for its loss by the government and the government is left with the remedy of foreclosure on a property that will never realize an amount approximating the sums advanced under the building loan agreement, particularly where the building is unoccupied and heavily vandalized as the appellant alleges in its complaint. Now, the appellant is asking that HUD do what it never undertook to do and insure the construction contractor for his losses as well.

Although the merits of this claim are not properly before this Court on the instant appeal, appellees believe that even a brief survey of the substantive issues reveals that the appellants are seeking to hold the Secretary liable for activities not authorized by Congress under the FHA mortgage insurance program.

Obviously, the Secretary is not authorized to enter into a construction contract or to insure such a contract. Some courts have viewed this principle as indicating that there can be no liability on the merits between HUD and the construction contractor. Appellees submit that the court below was correct in perceiving the more fundamental obstacle to such actions. If the activity is not authorized and not contemplated by the Congressional scheme of FHA mortgage insurance, it cannot be said that Congress has waived the sovereign immunity of the United States for suits by contractors to enforce "implied" construction or insurance agreements no matter what technical legal forms such actions assume.

CONCLUSION

The judgment dismissing the complaint against appellees should be affirmed.

May 17, 1976

Respectfully submitted,

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AFFIDAVIT OF MAILING

STATE OF NEW YORK
COUNTY OF KINGS
EASTERN DISTRICT OF NEW YORK, ss:

LYDIA FERNANDEZ, being duly sworn, says that on the 20th day of May, 1976, I deposited in Mail Chute Drop for mailing in the U.S. Courthouse, Cadman Plaza East, Borough of Brooklyn, County of Kings, City and State of New York, a BRIEF FOR THE APPELLEE of which the annexed is a true copy, contained in a securely enclosed postpaid wrapper directed to the person hereinafter named, at the place and address stated below:

Wasserman, Chinitz, Geffner
& Green, Esqs.
5000 Brush Hollow Road
Westbury, New York 11590

Sworn to before me this
20th day of May, 1976

Carolyn N. Johnson

CAROLYN N. JOHNSON
NOTARY PUBLIC, State of New York
No. 41-4618298
Qualified in Queens County
Term Expires March 30, 19 77

Lydia Fernandez

LYDIA FERNANDEZ